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PRICE VARIATIONS: THE DISTILLERS CASE
AND ARTICLE 85 EEC

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SHORTER ARTICLES, COMMENTS AND NOTES

PRICE VARIATIONS—THE DISTILLERS CASE AND ARTICLE 85 EEC

FEW cases have attracted so much interest in the tabloid press as the recent decision of the EEC Commission concerning The Distillers Company.¹ The Commission refused to grant an exemption under Article 85 (3) of the Treaty of Rome to the "Conditions of Sale and Price Terms" which Distillers imposed on its customers in contravention of Article 85 (1). As an immediate result of the decision, Distillers no longer offers for sale in the U.K. the Red Label and Dimple Haig brands of Scotch whisky.² It would seem that British Scotch whisky drinkers are now worse off as a result of the decision. As Continental prices of the Distillers' whiskies have not changed as a result of the decision, it would also seem that Continental devotees are no better off. Distillers asserts that a drop in sales and profits has occurred. It is doubtful whether many, if any, have benefited as yet from this decision. The case deserves careful attention from those involved in selling consumer products which require substantial advertising or promotion throughout the EEC.

I. THE FACTS

In the U.K. Scotch whisky accounts for more than one-half of spirit sales and in Belgium for perhaps one-third, but on the rest of the Continent its share is less than 5 per cent.³ Distillers has a very substantial share of the U.K. and Continental Scotch whisky market, but its share of the EEC spirit market is probably quite small, notwithstanding its sales of gin, vodka and Pimms.⁴

Until this decision, Distillers marketed the same brands of Scotch in the U.K. as on the Continent. Red Label, their leading brand, was very popular throughout the EEC. In contrast, Distillers' rivals have not enjoyed such broadly based success in any one brand. Rather, some brands such as Teachers and Bells are very popular in the U.K. (out-selling Red Label); whereas others, such as J. & B., are popular on the Continent.

If one compares the prices, net of duty and tax, of Distillers' whisky between countries, it appears that whisky is more expensive on the Continent than in the U.K. These higher prices appear to be the result mainly of higher costs but, to a small extent, of higher profit margins. According to Distillers, most of the higher costs were the greater advertising expenditures directed at consumers and the larger promotional expenditures directed at the retailers.

The Continental distributors paid for local promotional and other

¹ Commission Decision of Dec. 20, 1977: *Re The Distillers Co. Ltd.: Conditions of Sale and Price Terms*, O.J.1978, L. 50/16.

² Red Label and Dimple Haig are available to the U.K. trade for those wishing to order from the Continental distributors.

³ According to Distillers.

⁴ The Commission says that they have 40-50 per cent. of the U.K. market for Scotch whisky, 70 per cent. of the U.K. gin market and 25 per cent. of the U.K. market for vodka.

selling expenses. If they were to operate profitably, Continental wholesale prices had to be greater than U.K. wholesale prices.⁵ Given that the same brands were available in both countries, such a large price difference could only be maintained if trade in bonded whisky between the U.K. and the Continent was restricted in some way. Before June 1975, Distillers imposed an export ban on the U.K. trade as a condition of sale. This export ban was dropped after discussions with the Commission. However, Distillers instituted a dual pricing structure: as a condition of sale, the U.K. trade was required to pay a £5.20 surcharge for every case of whisky exported. Such a condition was intended to "protect" the Continental price. It was this condition which was the subject of the decision and which the Commission refused to exempt.

II. IMPLICATIONS FOR BUSINESSMEN

Let me indulge in some theoretical considerations. There are two options available to a firm whose goods require more intensive promotion in one market (A) than in another market (B). The first option is to offer only one brand and to promote that brand more intensively to people in A. The second option is to offer two brands (X and Y). Brand X can be intensively promoted to people in A. Brand Y is offered to people in B with less intensive promotion.

Firms wishing to offer a consumer product multinationally frequently face such conditions. If it is true that A and B are physically distinct markets separated by cultural or linguistic barriers so that people from A do not visit B and vice versa, then there is commercially speaking no difference between the two options *provided* the following conditions hold: first, that the cost of making two brands is no greater than the cost of making one brand (generally speaking this is true) and, secondly, it must be possible to charge a higher price in A than in B.

When prices reflect costs: prices in A will be higher than in B, on account of the greater costs of supply. It is also obvious that it is irrelevant to the people in A and B which option is chosen. Prices will be the same under either option.

If the goods are inexpensive to transport then under the single brand strategy it will not be possible to charge a higher price in A than in B unless the firm can impose a trading restriction between the two markets. (Such a restriction might be an export ban or a dual pricing structure for the trade in country B.) Under the two brand option, no restriction on trade between the two markets is necessary, for it is feasible to charge a higher price for X in A than Y in B. (Provided of course retailers are not allowed to buy Y in B, transport it to A, and then relabel it as X.)⁶

Once we relax the assumption of the separation of the markets and consider the case where people from A may visit B and buy the product in B, and vice versa, then the situation is changed. The options facing the firm are no longer identical. There are two possibilities. If the costs of persuading the retailers to stock both brands in both countries is *no*

⁵ The price difference net of transportation costs, local VAT and duty was between £5 and £9 a case of 12 standardised bottles.

⁶ This may not be illegal; see, for instance, *Centrafarm B.V. v. American Home Products Corp.* [1978] 2 C.M.L.R. 63.

greater than the costs of persuading them to stock one brand, then the two brand strategy is clearly preferable. People from A will find brand X everywhere and likewise people from B will find brand Y everywhere. People from A will buy X because it is the only brand which is advertised to them, even though it is more expensive than Y. People from B will buy Y because they know it and because it is cheaper. However, if, as is likely, the costs of persuading the retailers to stock both brands in both countries is greater than the costs of persuading them to stock one brand then the firm would prefer to offer only one brand in both countries. To offer only one brand would be a "second best," for under such an arrangement when travellers from A visit B they do not pay for the cost of the advertising which induced them to buy the brand. Likewise, travellers from B when in A pay much more for the advertising (and so buy too little). The higher price pays for advertising which they neither see nor care about.

Should the decision of the Commission on the illegality of dual pricing structures and export bans be upheld by the Court, then the choice of strategies available to businessmen in the future will be seriously limited in certain cases to their detriment. Moreover, firms who have unfortunately chosen the single brand option may now have to change to the two brand option. In doing this they will, like Distillers, suffer from a substantial loss of market share and profits from withdrawing a brand from one of the markets and replacing it with another. Moreover, when changing brand strategies, if they cut off supplies to a distributor they could be in danger of infringing Article 86 of the Treaty of Rome.⁷

III. PUBLIC POLICY AND THE CONSUMER INTEREST

Some people claim that advertising is purely wasteful. But anyone attempting to buy or sell a new or used car can testify to the saving of time and effort and money caused by some advertising.⁸ Adam Smith, the greatest advocate of consumer welfare, spent much time defending the middleman and justifying distribution expenses: low prices are of little use to the consumer if the goods come in the wrong form, to the wrong place or if their availability is not easily ascertainable. This is not to say that all advertising or promotional expense is necessary any more than all production expense is necessary, but rather I wish to point out that society will not be better off by needless criticism and rejection of the potential benefits from distribution expenses such as advertising and salesmen. In its decision, the Commission seems to have ignored the case put forward by Distillers that advertising and other middleman expenses were necessarily greater on the Continent than in the U.K. There is very strong evidence to suggest that the Commission hoped that the result of its decision would be a uniform price of Scotch whisky (in bond) throughout Europe.⁹ The price in the U.K. was thought to be too low and that on the Continent too high. It is not difficult to see that a uniform price for whisky might have

⁷ See, for instance, *United Brands Co. v. The Commission of the E.C.* [1978] 1 C.M.L.R. 429.

⁸ See, for instance, L. Benham, "The effect of advertising on the price of eyeglasses" (1972) xv (2) *Journal of Law and Economics* 337.

⁹ According to Distillers, this is what the Commission appeared to expect them to do.

adverse consequences on efficiency. For under uniform pricing, the pressure of competition would probably lead to the brand disappearing from one market, either because its price was too high or because its promotion was too low. However, if uniform prices were sustainable, there would be adverse effects on the distribution of income: U.K. buyers would be subsidising continental advertising directed at Continental buyers.

IV. DISCRIMINATORY TARIFFS

Distillers argued that the existence of discriminatory tariffs against whisky sales on the Continent was another, separate justification for allowing the dual pricing structure.¹⁰ Such discrimination by member countries may be contrary to Article 95. The Commission did not spell out in their decision their position on this important point of principle. However, in an informal communique they said that the argument was not acceptable on the grounds that two wrongs do not make a right. Surely there are situations where one restriction justifies another. U.K. antitrust law recognises this.¹¹ It is hoped when the appeal is heard that the Court will clarify the circumstances under which one restriction can justify another.

V. BUYING POWER

A small part of the price difference between the U.K. and Continental prices could be attributed to the higher profitability that Distillers earned on the Continental trade.¹² This is a clear case of price differences not reflecting cost differences ("price discrimination"). Distillers argued that the higher profitability was a reflection of the fact that the U.K. buying trade, which is concentrated in a few hands, had tremendous buying power.¹³ It is important to note that it appears that Distillers did not argue that they were making insufficient profits in the U.K. to make investment worth while.

From the economist's point of view, the ability of the U.K. trade to negotiate prices down to costs is to be admired.¹⁴ But the existence of buying power in the U.K. market could have had no effect on the Continental prices, for the U.K. and Continental markets were separated. Nor will the decision of the Commission reduce the power of the company to continue to obtain higher margins on the Continental trade. This is because different brands now circulate in different markets.

The businessman should be wary, for price differences not accounted for by differences in costs are hard to justify to economists as being

¹⁰ According to Distillers, the difference in the taxes payable (including VAT, customs duty, etc.) between Scotch and the least taxed rival spirit was as follows: U.K. nil, Belgium 3p, Germany 4p, Italy 41p, France £1.11, Denmark £1.45.

¹¹ See, for instance, *Re National Sulphuric Acid Association's Agreement* (1963) L.R. 4 R.P. 169. There the court found that the restrictions in an agreement were not contrary to the public interest as it was required to counteract the U.S. export cartel "Sullexca."

¹² See 2.21 (b) of the Decision.

¹³ The five largest customers took 40 per cent. of the U.K. sales. The power of these customers is described in the U.K. Monopolies Commission: *A Report on the Supply of Beer* (1969).

¹⁴ A concept used to include a normal return on capital employed.

in the consumer interest, and even harder to justify to public policy makers as being good in practice.¹⁵

VI. CONCLUSIONS

The decision is another example of the Commission's attempts to integrate the European market and to promote the consumer interest which in practice has created few benefits for the consumer in either the short or long run. In the light of the outcome of the case one is led to conclude that the Commission was misguided. Moreover the absence of reasoned argument has only served to increase the confusion among businessmen and increase the hostility between the business community and the Commission.

C. W. F. BADEN FULLER.¹⁶

THE REALISTIC APPROACH TO THE RECOGNITION OF FOREIGN DIVORCES

*Newmarch v. Newmarch*¹ is an interesting decision by Rees J. on recognition of a foreign divorce decree and on the power of an English court to award maintenance. It raises points of law connected with two recent statutes, the Recognition of Divorces and Legal Separations Act 1971 and the Maintenance Orders (Reciprocal Enforcement) Act 1972. As yet these important statutes have provoked little reported case law; such as there has been is either uncontroversial or so briefly reported as to be practically valueless as precedent.²

Mr. and Mrs. Newmarch were married in England in 1947. In 1968 they bought a house in Cardiff. Early in 1969 they went to live in Malaya, where the husband had acquired a job as a university lecturer. They did not sell their house in Cardiff. The wife did not like Malaya, so later in 1969 they moved to Australia. Being no happier there the wife got her husband to agree to her returning to England in June 1970. In December 1971 she returned to Australia to live with her husband, but by that time he was living with another woman and he refused to resume cohabitation with his wife. She returned to England and in March 1974 she applied to the Bournemouth County Court for maintenance under section 27 (1) (a) (i) of the Matrimonial Causes Act 1973.³ On July 16, 1974, a county court judge awarded her maintenance of £125 per month. On July 30, 1974, the husband began divorce proceedings in New South Wales. The wife was personally served with the petition and the form of notice on October 14, 1974, but despite repeated

¹⁵ See, for instance, F. M. Scherer, *Industrial Market Structure and Economic Performance* (Chicago, 1970).

¹⁶ I am grateful to Dr. V. Korah for encouragement and helpful comments, and to The Distillers Company for supplying information. All opinions are the author's and all errors are his responsibility.

¹ [1978] 1 All E.R. 1; (1977) 7 Fam. Law 143; [1977] 3 W.L.R. 832. The fullest account of the facts is to be found in the W.L.R.

² On the 1971 Act: *Hack v. Hack* (1976) 6 Fam. Law 177; *Kendall v. Kendall* [1977] 3 W.L.R. 251. On the 1972 Act: *Re McK.*, *The Times*, July 14, 1976.

³ s. 27 (1) (a) (i) provides: "Either party to a marriage may apply to the court for an order under this section on the ground that the other party to the marriage . . . being the husband, has wilfully neglected . . . to provide reasonable maintenance for the applicant."